SUITS FOR ACCOUNTING ON TONTINE LIFE INSURANCE POLICIES.

TONTINE policies of life insurance are seldom issued in this country now, and are, as a matter of fact, prohibited by law in many states of the United States, in England and most of the countries of Europe. However, the abandonment of this form of policy has been recent enough to make a study of its features serviceable to the lawyer in many instances. A grasp of the principles upon which the premium on a life insurance policy is based may be valuable in connection with the ordinary endowment policy, or, in case of disputed right to ownership of annual dividends, or in questions arising out of attempts of creditors to subject dividends on insurance policies, or the cash surrender value of the policy, to their claims.

In order to understand thoroughly the meaning of life insurance terms, it is necessary for the lawyer to put from his mind for the time the usual definitions of such terms as "dividends," "reserve," "surplus," and a few others, and to think of them only as they are used in life insurance. It will not be attempted, in this article, to explain at length the methods of computing premiums, reserve, dividends, etc., but we will have to content ourselves with a very brief general definition of the terms.

PREMIUM.

The premium is the sum paid by the insured to the insurer for the indemnity, or benefits, which the latter sells.

It may be a single payment, or a series of annual, semi-annual, quarterly, monthly or weekly payments.

The net premium is the amount calculated from mortality tables as being sufficient to pay all death losses. From mortality tables, based on observations extending over many years and thousands of lives, it can be told with accuracy how many, of say 100,000 people of a certain age, will die each year until the last of these is dead. Insurance companies deal, not with a

few lives, but with thousands and even millions, and the greater the number the truer their rule of average works out.

Knowing the number of probable deaths at each age for each year the company can know the amount that must be paid out in death losses each year; also how many of that class will survive each year to pay premiums, and how much interest, at an assumed rate (usually 3 per cent), will be earned upon the amounts paid in. As the deaths among a certain class will be less in its early years, and increase in proportion to the remaining members of the class in the later years, it is evident that a sum must be stored up in the early years to meet the liabilities of the later years. By a mathematical calculation an amount is derived, which, when paid in each year by each of the members of the class, with interest at the assumed rate (usually 3 per cent) compounded annually, will be sufficient to pay all the death losses of the class as they occur. This amount is designated the net premium.

RESERVE.

But the amount collected in the net premium each year is necessarily more than enough to pay the death losses of that year; the excess each year is put by to be invested in order to store up something against the "lean years" when the policy holders are fewer in number and the death losses greater in proportion. This amount put by each year, added to similar amounts put by in preceding years, and all invested to take care of future death losses, is the reserve.

It can readily be seen that it is not like the reserve of an ordinary business, put by in case of some possible contingency, or unexpected need, but it is for the purpose of taking care of a liability that is sure to occur, i. e., the future death losses.

SURRENDER VALUE.

It is well to notice here that a policy holder, in the early years of his policy, pays in more than his pro rata of death losses for those years, in order to store up for the later years of his class. Therefore, when he allows his policy to lapse, for any reason,

he has a certain rebate, or unearned portion, of the net premium belonging to him in the hands of the company, which the companies, in most states, are compelled to apply to purchase of paid up insurance, or to extend the term of the policy. Insurance cases have been reported in which this unearned premium (sometimes designated as "cash surrender value") has been sufficient to extend the term of a policy, supposedly lapsed, so as to cover the date of the death of the insured.

Dividends retained by the company must also be so applied, in case of lapse, in most states, notwithstanding forfeiture provisions of the policy, and are customarily so applied by the insurance companies even in the absence of compulsory legislation. Where the company holds such dividends they form a part of the "cash surrender value."

Loading.

To the net premium must be added an amount to pay the expenses of conducting the business, obtaining new business, maintaining offices, hiring actuaries, paying officials, and other expenses. Then there is the possibility that less than three per cent may be earned, or that an unusally large number of deaths may occur.[1] To cover these expenses and contingencies an amount is calculated and added to the net premium. This is called loading.

Surplus.

It will often occur—practically always does occur—that the death loss in any year, certainly in any period of years, is in actuality less than that contemplated. This does not mean an immediate gain of the difference between the expected death loss and the actual—for those who do not die this year will die another year, in the end the death loss will have to be paid. But it does mean that this difference between the expected death loss and the actual will be held invested for a longer

[1] In modern insurance this contingency may be eliminated: the mortality tables are calculated to, and do, cover every such contingency, and a heavy death loss one year, or in one place, is balanced by a light one in another year or place.

time, and that more premiums will be paid in by the survivors of the class whose death had been expected that year than had been calculated upon, and that those additional premiums will be invested and yield income. This is one of the sources of surplus.

Another source of surplus lies in the fact that the expenses do not equal the amount calculated in the loading to cover them and collected with each premium. Then again, as we noted above, in the loading it is calculated that three per cent may not be realized upon investments, and an amount was added to the premium to cover this contingency. As a matter of fact from four and one-half to five per cent net is practically always realized upon the investments of insurance companies, and this, after charging all investment expenses and losses from bad investments against the income. Here, then is another source of surplus. Hence the surplus is made up of gains:

(1) From the lower mortality rate than calculated upon.

(2) From realization of a higher rate of income on investments than calculated upon.

(3) From expenses being less than calculated upon for purposes of the loading.

DIVIDENDS.

A mutual insurance company is not entitled to make any profit from its policy holders, or otherwise. The policy holders become members for their mutual protection as a primary object. The object, and sole object, is to furnish its members the best possible protection at the lowest possible cost. There is no reason whatever for keeping a surplus in the hands of the insurance company. Its policy holders are in all parts of the world, are numbered by tens of thousands, and even millions, the risks are selected, scientific and medical advancement cut down the probabilities of death every day. Moreover, the mortality tables are based on observations made the world over among millions of people in every part of the world, and with every possible contingency taken into consideration. Under the law of averages the death rate is fixed—a higher death rate in

Illinois one year will be balanced by a low death rate in New York the same year, or by a lower one in Illinois the next year. The death loss, therefore, is on the average fixed, and the reserve is so calculated that it always has been, and always will be, ample to take care of the death loss under every possible contingency. The question then arises, what shall be done with the surplus? Really it is not a surplus; it is simply an over-payment of premium and "belongs equitably to those who contributed it."[2] It is paid back to policy holders according to various methods of apportionment and designated as dividends.

Annual Dividends.

Dividends are usually paid annually—must be paid annually under the laws of certain states.

Tontine Policies.

Under a class of policy very commonly sold up to the time of the late nineties, and sometimes later, the policy holder agreed to leave all his dividends with the company to accumulate until the end of a certain period, usually ten, fifteen or twenty years, with the provision that should he cease to be a member of the company before the end of this accumulation period his share of the dividends should go to those of his class who persisted as policy holders until the completion of the period. These policies were termed variously "deferred dividend," "accumulated dividend" and "semi-tontine" policies. Those who accepted policies on this plan expected large gains in addition to the protection they bought. Agents, armed with estimates and calculations, furnished by their companies, flooded the country. In many cases the policies when issued by the companies, had attached to them so-called "estimates" of the amount of dividends which the policy holder should receive upon completion of the deferred dividend period. Doubtless many of the companies were honest in their expectations.

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[2] See Spinks *v.* U. S. Life Ins. Co., 126 Ky. 405, 96 S. W. 889; Equitable Life Ins. Co. *v.* Winn, 137 Ky. 641.

Some, at least, kept special accounts so as to be able to show the dividends really earned by policy holders of this class, but a great many of the companies, having benefitted by very large increase in the sales of policies upon the issuance of policies of this kind, kept no special accounts, made no distinction whatever between this and the ordinary life policy without the deferred dividend features, and made no calculation of dividends until completion of the deferred dividend period. The results in most companies, particularly the New York companies, have been most disappointing. The accumulation of these dividends was a constant temptation to extravagant management, extravagance in expenses, extravagance in favors and graft charged up to expenses, and a mass of other unsavory extravagances brought to light in the Armstrong investigations in New York.

At various times policy holders of the deferred dividend, or semi-tontine class, have attempted to learn something of the manipulations of their surplus in the hands of the companies. These attempts, so far as the reported cases show, have been made in three states, New York, Massachusetts, and Kentucky.

The New York courts have been slow to accept the doctrine that there is any trust relation between the insurance company and the holder of the "tontine" policy, or that the policy holder is entitled to an accounting. In the case of Uhlman *v.* N. Y. Life Ins. Co.,[3] a holder of matured, tontine policy filed bill in equity asking for an accounting from the insurance company on two grounds, viz:

(1) That relation between the company and insured was not simply one of contract but was similar to one of trustee and cestui qui trust.

(2) That the account was of so difficult and complicated a nature that it could not be properly tried at law, and hence action in equity is the appropriate remedy.

In overruling point (1) the court said:

> "The situation of the parties is simply that of debtor and creditor, the amount of such debt being determinable by this equitable apportionment, which taking the language of

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[3] 109 N. Y. 421, 17 N. E. 363.

the policy into consideration, necessarily means that the apportionment is to be made by the corporation through its officers. * * * Prima facie the apportionment as made by the defendant should be regarded as an equitable apportionment: * * * it ought to be presumed that it has performed its duty instead of presuming that it has failed to do so."

In overruling point two (2):

"Whether or not the court would take jurisdiction upon the sole ground of the account being complicated is a matter largely in discretion of the 'court:' * * * there is a balance of inconvenience to the defendant."

But the court added:

"We do not, however, accede to the claim of the defendant herein to its full extent as made in the brief submitted, which is, that the apportionment as made by the defendant is absolutely and at all events conclusive upon the policy holders. We hold that under the terms of this policy the apportionment was to be equitably made, and, in the first instance, by the defendant's officers or agents. But inasmuch as the agreement is that the apportionment shall be an equitable one, the question of what is an equitable one, all the facts and circumstances being known, *may be one over which the courts have supervision.* Prima facie, the apportionment as made by defendant should be regarded as a compliance with the terms of the policy, or, in other words, should be regarded as an equitable apportionment. But the question is still left, has or has it not complied with its agreement to make an equitable apportionment? And *the plaintiff and all others similarly situated have the right, upon proper allegations of fact showing that the apportionment made by the defendant is not equitable, or was even based upon erroneous principles, to have a trial and make proof of such allegations, and if proved the court will declare the proper principles upon which the apportionment is to be made, so as to become an equitable apportionment.*"

And in Greef *v.* Equitable Assurance Society,[4] defendant's charter required distribution of an equitable portion of its sur-

[4] 160 N. Y. 19, 54 N. E. 112 (1899).

plus to each policy holder. Plaintiff took out a policy entitling him to participate in the distribution of the surplus of the society according to the principles and methods that might from time to time be adopted by it, and brought an action at law to recover dividends in addition to those allowed him. The court's ruling is indicated in the following quotation:

> "Before any amount of the surplus was available as a credit upon plaintiff's policy, the proportion which equitably belonged to him, * * * must be ascertained and determined. Until that was done no action at law could be maintained to recover any portion of it. * * * It may be that if the defendant had failed or refused to ascertain and distribute the portion of the surplus which equitably belonged to the plaintiff, he could compel it to act and determine the amount."

The question has arisen in the Federal Courts, in New York chiefly, and those courts have followed the New York courts in construing the New York law, as laid down in the cases just quoted, qualifying their decisions with expressions to the effect that no sufficient allegation of fraud has been made.

The United States Supreme Court, in Equitable *v.* Brown,[5] also construed the New York law as refusing to the policy holder, in a mixed stock and mutual company, the right to maintain a suit in equity for an accounting. But that case was complicated by allegations seeking the appointment of a receiver and an attempt to wind up, or readjust, all the business of the company and its management. From the opinion and the abstracts of briefs, as reported, the court does not seem to have gone into the theory upon which the premiums were based, nor to have had its attention called thereto, nor to have gone into an analysis of the sources of the surplus.

It is worthy of consideration that the surplus of a mutual insurance company is contributed by its policy holders in the shape of over payments of premiums, and "belongs equitably to those who contributed it" in over payments; that it should be returned to those who contributed it and not held for accumulation, or

[5] 213 U. S. 25.

paid to policy holders of a later or different period, or class, than the contributors. This theory is carried out now in the laws of many states, requiring a distribution by insurance companies of their surplus annually. In this way the over payment is required to be returned to those who contributed it, while they are still members of the company, and not held to be distributed later when perchance fifty per cent of those whose over payments made it up have ceased to be members through lapses or death.

A surplus is not only not necessary to a mutual insurance company, but it is a source of temptation to its officers, and keeping on hand a surplus after payment of annual dividends is inadvisable from any standpoint, and a sign either that the company's calculations are faulty, or that the company is not fair to its policy holders.

In case of a mixed stock and mutual company, the stock holders, having received the maximum dividend to which they are entitled and annual dividends having been paid to the policy holders, what is to become of the accumulated surplus? It will either be paid later to policy holders who did not contribute it, or it will remain in the hands of the insurance company to be manipulated by the directors and officers. In these manipulations the surplus must either be gradually lost, or vastly increased from time to time. In any case the policy holders who contributed it get no benefit. Other courts have refused to approve the cases cited above, which left a huge surplus in the hands of a company whose stockholders can not get it (lawfully) and whose future policy holders are not equitably entitled to share in it.

In case of a strictly mutual company the temptation to the officers and directors is likewise present, and, although theoretically these officers and directors are subject to the vote of the policy holders for their tenure of office, practically their succession is perpetual and only their own little circle exercises its right to vote. The thousands of members scattered over the whole world make concerted action of the policy holders impossible.

Among the courts of other states that have been more liberal

to the policy holders and have refused the insurance companies the protection of a strained technical ruling in such cases, are those of Massachusetts and Kentucky.

Some capital may be made, on behalf of the insurance companies, of the point that a Massachusetts' statute gives jurisdiction to a court of equity "where the nature of the account is such that is can not be conveniently and properly adjusted in an action at law." It may be remarked that this statute is found in many other states than Massachusetts, and, moreover, the court seems to indicate that a court of equity would have had jurisdiction even in the absence of such a statute.

The principal decisions holding the insurance company liable to such an accounting are the following:

PIERCE V. EQUITABLE LIFE ASSURANCE SOCIETY.[6]

This was a suit for an accounting in equity by the holder of a matured tontine policy against the assurance society. The court held plaintiff entitled to such an accounting, saying:

> "Our statute gives jurisdiction in equity upon accounts 'where the nature of the account is such that it can not be conveniently and properly adjusted in an action at law.' Even if the amounts kept back from plaintiff and those of his class of policy holders, by retention of those dividends, which would otherwise have been received, or of those sums accruing from the forfeiture of policies either in whole or in part, do not constitute a trust fund, or place the defendant in a strictly fiduciary capacity, the defendant was bound to keep accurate accounts of them and of all interest and profit thereon, if any. All the facts were entirely within its own knowledge and it is only thus that it could be determined what equitably should be apportioned to the plaintiff. * * * A court of equity is the proper tribunal for dealing with such an account, and the defendant is fairly bound to produce an account, from the data in his possession, which shall show that he has complied with his promise equitably to apportion to plaintiff his share in the accumulations made through the operation of the tontine provision of his policy."

[6] 145 Mass. 56, 12 N. E. 858.

UNITED STATES LIFE INS. CO. v. SPINKS.[7]

In the Spinks case the insurance company defended a suit brought by the beneficiary under one of its policies upon the ground that the policy had lapsed prior to the death of the insured, for non-payment of premiums. The plaintiff contended that the company was a mutual one and should have apportioned a greater amount of dividends to the policy than it had allowed, and that the dividends properly belonging to the policy, but not apportioned to it by the company, would have extended the term of the policy beyond the date of the death of the insured. The court, in its opinion, states the questions for decision thus:

> "The questions for decisions are two: First, What is the meaning of the term 'dividend additions,' as used in the New York statute which is quoted ante? Second, Was there due to be applied to this policy at the date of the default in premiums, a sum sufficient of such dividend additions, when added to the value of its reserve, to have paid for an extension of the insurance to and including September 13, 1898?"

The court held that the defendant company should have kept an account with the class of policies to which that of the plaintiff belonged in order that it might properly apportion to it the dividends, that the amount of dividends which should have been apportioned to the plaintiff's policy and to which he was entitled by default upon defendant's failure to furnish an accounting was sufficient, when added to the value of its reserve, to have paid for an extension of the insurance to and including the time of the death of the insured.

EQUITABLE LIFE ASSURANCE SOCIETY v. WINN.[8]

In this case the plaintiff, having persisted until the end of the tontine period, sought an accounting from the defendant insurance company upon his tontine contract of insurance and to recover dividends in addition to the amount which the company had apportioned to him. The court held that the plain-

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[7] 126 Ky. 405.

[8] 137 Ky. 641, 126 S. W. 153.

tiff was entitled to such an accounting and entered into a discussion of the relation existing between the company and the holder of a tontine contract of insurance with the company. The Winn case further establishes beyond controversy, that the ascertainment or apportionment by the company to the insured, of his share of the surplus or dividends, is not final and binding upon the insured, but that the insured is entitled, to use the language of the policy, to "the amount equitably belonging to his policy:"

> "Appellant did not deny the issual of the policy, its engagements, the performance by the plaintiff of its conditions, his selection of an option under its terms, the settlements made, and the representations on which it was made. When so much was admitted, the law imposed upon appellant the duty of keeping accounts with its policy holders, from which it could be ascertained what was due to be apportioned among them according to the terms of the contracts."

Again, in prescribing the duty of the company, the court uses the following language, on page 646:

> "Here the law likewise imposes certain duties and obligations upon the insurance company who undertakes for pay to invest its policy holders' fund in an enterprise, such as a tontine policy of life insurance. The company cannot satisfy its contract by saying that it apportioned to the policy all that was due under it. It must show what was due under it—how ascertained, and from what sources—else it becomes the judge as well as contracting party."

It is not to be thought that all of the large insurance companies have treated the holders of their tontine policies with injustice. Certainly some of them kept accounts with classes of policy holders and apportioned their dividends fairly. These companies can, and, in some instances, have rendered, in suits brought for the purpose of compelling it, accountings, and have shown that they kept accounts with their tontine policy holders as classes and fairly apportioned the dividends. A remarkably clear and fair accounting of this character was furnished in a

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recent suit against a large mutual insurance company, of the Middle West, which suit came under the writer's observation.

An illustration of the method of keeping accounts with classes, as contended for by tontine policy holders, is furnished in the following quotation from an answer of an insurance company to an interrogatory addressed to it by a policy holder:

> "After the policies in the group or class (of policies) have been in force for one year, to-wit, at the end of the first policy year, the company could, by applying its average expense, interest and mortality rates to the group, ascertain the proportion of its total surplus or profits derived from such group. That part would be expressed in so many dollars and cents of profits apportionable to the group.
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> "The company might then conditionally apportion the profits among the insurances in force at the expiration of the first policy year and each policy would be conditionally credited with so many dollars of profits.
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> "After the group had been in force two full years, to-wit, at the end of the second policy year, the company, by again applying to the group the average expense, interest and mortality rates of the year, could ascertain what part of its total surplus and profits for that second policy year had been derived from that group. That part would be expressed in so many dollars and cents, and would be the amount of surplus or profits (earned during the second policy year) which was derived from the policies in force in the group in question; such sum could be conditionally apportioned to the policies in force at the end of such second policy year and each policy would receive a conditional apportionment of a certain sum.
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> "It would be found that some policy holders, however, did not pay the second premium, or died during the second year, and therefore their policies were not in force at the end of the second policy year. Such discontinued policies had, however, *previously* been conditionally credited with their respective proportions of the profits of the first policy year, which profits were of course still in the hands of the company. The company could readily take the amount of profits which had thus been conditionally credited at the end of the first year to those policies which thereafter discontinued in the second year, and set the same aside in funds known as the 'profits from lapsed policies' or of 'profits from (dead) policies.'

> "(This is just the kind of fund that the plaintiff apparently has in mind in the present interrogatory (No. 2) when he speaks of a 'tontine fund which was created and increased each year by death, lapses, interest and loading'.)
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> "Each year thereafter, the same operation would be repeated, so that whenever a policy discontinued by lapse or death, the profits that had theretofore been conditionally apportioned to it would be added to the 'tontine' fund of 'profits from lapsed policies' or of 'profits from (dead) policies'. At the expiration of the 20-year distribution period, the policies that still remained in force would receive first, the aggregate sums which from year to year had been conditionally apportioned to themselves, accumulated with interest, and second, their equitable proportion of the separate accumulated 'tontine' fund of 'profits from lapsed policies' and 'profits from (dead) policies.'
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> "Such a method might have been adopted; but this company did not adopt that plan and hence can not answer the question based on the assumption that it did have such a plan in force."

This answer, while not entirely accurate and correct in some particulars, is a very good description of the kind of account (with a few changes) which, it seems, mutual insurance companies should have kept with their tontine policy holders.

The policy holder does not ask an accounting of all the business of the mammoth company. He only asks for a statement of his own account; if he is entitled to gains from lapse of other members of his class, or other sources, what those gains and sources were. If the company has kept the account with his class, it can easily furnish it to him. The answer of the company who did not keep such accounts, that it would be too big an undertaking and too inconvenient to furnish an accounting, is of little weight and has been treated with sarcasm by most courts.

An examination of the many decisions on questions of jurisdiction of courts of equity in cases of complicated accounts, trust relations, and discovery, would be beyond the scope of this article, but the general trend of the decisions and the general principles of equity practice would seem to bear out the right of the tontine policy holder to an accounting of the funds of his

group, or class, of policies; otherwise, he must take the apportionment of the company as equitable, without question, and, as remarked in Equitable *v.* Winn,[9] "the company becomes the judge as well as the contracting party."

Ellerbe W. Carter.

LOUISVILLE, KY.

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[9] Supra.